



DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL

DEC 09 2003

Office of Audit Services  
Region I  
John F. Kennedy Federal Building  
Boston, MA 02203  
(617) 565-2684

CIN: A-01-03-02500

Mr. Stephen Geller  
Executive Director  
Rockingham Community Action, Inc.  
7 Junkins Avenue  
Portsmouth, New Hampshire 03801-4511

Dear Mr. Geller:

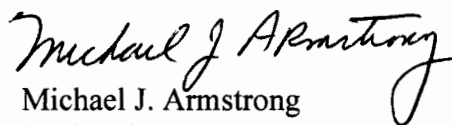
Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General's Office of Audit Services' (OAS) report entitled "*Costs Charged to Head Start Program Administered By Rockingham Community Action, Inc.*" for FY 2000-2002. The objective of our review was to evaluate the financial system and internal control structure for tracking and reporting Head Start activity at Rockingham Community Action, Inc. (the Agency) for the three fiscal years (FY) ending July 31, 2002. A copy of this report will be forwarded to the action official noted below for his/her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-01-03-02500 in all correspondence relating to this report.

Sincerely yours,

  
Michael J. Armstrong  
Regional Inspector General  
for Audit Services

**HHS Action Official**

Mr. Hugh F. Galligan  
Regional Administrator  
Administration for Children and Families (ACF)  
US Department of Health and Human Services  
John F. Kennedy Federal Building, Room 2000  
Boston, MA 02203

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**COSTS CHARGED TO HEAD START  
PROGRAM ADMINISTERED BY  
ROCKINGHAM COMMUNITY ACTION,  
INC.**



**DECEMBER 2003  
A-01-03-02500**

# *Office of Inspector General*

<http://oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



## **EXECUTIVE SUMMARY**

### **OBJECTIVE**

The objective of our review was to evaluate the financial system and internal control structure for tracking and reporting Head Start activity at Rockingham Community Action, Inc. (the Agency) for the three fiscal years (FY) ending July 31, 2002.

### **BACKGROUND**

Head Start is a discretionary grant program enacted under Title V of the Economics Opportunity Act of 1964 and is administered by the Administration for Children and Families (ACF) within the Department of Health and Human Services (DHHS). The Head Start program provides children from low-income families with daily nutritious meals and many opportunities for social, emotional, and intellectual growth that can prepare them for success in school and in life.

The Office of Inspector General was asked by the ACF Region I Office to assess the solvency of Rockingham Community Action, Inc., the organization that administers the Head Start and other community programs in the metropolitan area of Portsmouth, New Hampshire. During FY 2002, the Agency received \$1.4 million to provide Head Start services to 177 children.

Federal regulations (45 CFR 1304. and 45 CFR 74) require Head Start grantees to establish and maintain efficient and effective financial reporting systems.

### **FINDINGS**

The Agency did not maintain an efficient and effective financial system for tracking, reporting and retaining support for Head Start transactions as required by Federal regulations. Our analysis showed:

1. Indirect costs recorded to the general ledger included errors and unsupported transactions, and did not reflect offsets to the base (direct costs) for calculating indirect costs. For example, there was:
  - \$16,905 in reconciliation errors between the Head Start general ledger and the approved budget. Specifically, actual costs reported in the general ledger exceeded the approved budget by \$13,807 in FY 2001 and fell short by \$3,098 in FY 2002.
  - \$14,646 in unsupported adjusting entries in FY 2000.
  - \$39,936 in offsets to direct costs not reflected in the calculation of indirect costs, nor did supporting records for the offsets provide enough detail to determine whether they applied to allowable costs.

2. Federal cash drawdowns for one of three fiscal years tested exceeded the approved budget. Specifically, \$69,737 in drawdowns for FY 2001 could not be supported by actual costs claimed.
3. Supporting documentation could not be located for in-kind contributions. Specifically, \$277,429 in in-kind contributions for FY 2001 could not be substantiated.

Without adequate financial controls, the risk is high that Federal funds could be misappropriated and not be used to serve children enrolled in Head Start.

The errors we identified can be most attributed to high turnover and a poorly executed accounting software conversion in FY 2000. During our review, however, the Agency hired a new Fiscal Director with relevant experience who is working with an independent consultant to improve fiscal operations.

## **RECOMMENDATIONS**

We recommend that the Agency continue to improve its record keeping procedures and financial systems. The Agency's strategy to improve fiscal operations should include training staff and implementing adequate controls to ensure that:

- actual indirect costs recorded to the general ledger are reconciled to the approved budget;
- direct costs reflect any allowable offsets prior to calculating indirect costs, and supporting records list which accounts or costs apply to the offsets;
- there is a clear and supported audit trail for cash transactions;
- total drawdowns should not exceed actual costs allowed by the approved budget; and
- in-kind contributions are supported by source documents.

To further strengthen controls and record keeping, the Agency should consider establishing a cash account in the Head Start general ledger and a separate checking account.

## **MANAGEMENT COMMENTS AND OIG RESPONSES**

The Agency agreed with our findings and has either adopted or plans to adopt corrective actions for each of our recommendations. We concur with the Agency's corrective action plan and emphasize that management should implement it in a timely manner.

## **TABLE OF CONTENTS**

<b>INTRODUCTION</b>	<b><u>Page</u></b>
<b>BACKGROUND</b>	1
<b>OBJECTIVE, SCOPE AND METHODOLOGY</b>	1
<b>FINDINGS AND RECCOMENDATIONS</b>	4
<b>CRITERIA</b>	4
<b>INDIRECT COST</b>	5
<b>FEDERAL CASH DRAWDOWNS</b>	5
<b>UNSUPPORTED IN-KIND CONTRIBUTIONS</b>	6
<b>HIGH TURNOVER AND LIMITED TRAINING OF FISCAL     DEPARTMENT STAFF CONTRIBUTED TO ACCOUNTING     ERRORS</b>	6
<b>RECOMMENDATIONS</b>	7
<b>MANAGEMENT COMMENTS AND OIG RESPONSE</b>	7
<b>APPENDIX -     Rockingham Community Action, Inc.’s                     Response To Draft Report</b>	



## **INTRODUCTION**

### **BACKGROUND**

Head Start is a discretionary grant program enacted under Title V of the Economics Opportunity Act of 1964 and is administered by the (ACF) within the DHHS. Major program objectives include:

- promoting school readiness by enhancing the social and cognitive development of low-income children through the provision of comprehensive health, educational, nutritional, social and other services;
- involving parents in their children's learning; and
- helping parents make progress toward educational, literacy, and employment goals.

The Office of Inspector General was asked by the ACF Region I Office to assess the solvency of the Agency, the agency that administers the Head Start and other community programs in the metropolitan area of Portsmouth, New Hampshire. Concerns raised by ACF officials included:

- redirecting of Head Start funds to other programs;
- providing required financial reports in an untimely manner or not at all;
- receiving denial for loans or to cash checks from banks; and
- drawing down excessive amounts of Federal funds.

The Agency is a private, non-profit organization dedicated to creating solutions to poverty in its local community. The Agency accomplishes its mission by providing a comprehensive array of services including Head Start, adult education, job search, and homelessness prevention, to name a few. During FY 2002, the Agency received \$1.4 million to provide Head Start services to 177 children.

### **OBJECTIVE, SCOPE AND METHODOLOGY**

Our review was performed in accordance with generally accepted government auditing standards. The objective of our review was to evaluate the financial system and internal control structure for tracking and reporting Head Start activity at the Agency for the three FYs ending July 31, 2002.

We performed limited tests and procedures that we considered necessary to evaluate the Agency's internal control structure design and operation. This included a review of the internal control policies and procedures related to cash withdrawals, disbursements, and purchases for the period of August 1, 2000 through July 31, 2002.

We accomplished our objectives by:

- Reviewing the Agency's A-133 single audit for the period FY 2000 to FY 2002.
- Reviewing pertinent Federal laws and regulations, including:
  - 45 CFR Part 1301 to 1304;
  - 45 CFR Part 1301.20;
  - 45 CFR Part 1305; and
  - 45 CFR Part 74.
- Reviewing grant documents issued by ACF from FY 2000 to FY 2002, including the financial award that contains the annual budget by line item.
- Reviewing the minutes of the Board of Directors and the Policy Council meetings for the period of August 1, 2000 through July 31, 2002.
- Obtaining an understanding of the Agency's policies and procedures and internal controls relating to its financial functions, including indirect costs, Federal cash drawdowns documented on Form PSC-272, credit history, and costs reported to ACF on Form 269.
- Performing a ratio analysis for solvency, profitability, and stability for each fiscal year.
- Reconciling reported actual costs (Form 269) to the approved budget (financial award).
- Determining whether Federal cash drawdowns were used for Head Start expenses by defining the audit trail and testing material transactions and activity for each year, including:
  - reconciling total Federal cash drawdowns to bank statements;
  - tracing Federal cash drawdowns to the RCA cash account;
  - tracing total Federal cash drawdowns to total actual costs;
  - tracing Federal cash drawdowns to subsidiary records of supporting costs;
  - tracing subsidiary records to the Head Start general ledger; and
  - judgmentally selecting a sample of transactions from the Head Start general ledger
  - tracing them to supporting documentation.
- Reviewing the Head Start general ledger for any unusual or irregular items, which included adjusting entries, uncommon accounts, and line items greater than \$2,000.
- Reviewing the working papers prepared by the independent auditor to determine whether payroll costs for FY 2000 to FY 2002 were allowable, including fringe benefits.
- Defining "Other" costs listed in the financial award and determining whether claimed costs were allowable.

- Determining whether amounts charged for indirect costs were reasonable and allowable.
- Determining whether the Agency complied with financial reporting standard.
- Determining whether the Agency's treatment of expenses, capital, and leases were appropriate and related claimed costs were allowable.

Our audit was conducted at Rockingham Community Action, Inc., in Portsmouth, New Hampshire and at our regional office in Boston, Massachusetts. Fieldwork was performed from October 23, 2002 through August 13, 2003. On November 10, 2003 the Agency responded to our draft report (See Appendix).

## FINDINGS AND RECOMMENDATIONS

The Agency did not maintain an efficient and effective financial system for tracking, reporting and retaining support for Head Start transactions as required by Federal regulations. Our analysis showed:

1. Indirect costs recorded to the general ledger included errors and unsupported transactions, and did not reflect offsets to the base (direct costs) for calculating indirect costs.
2. Federal cash drawdowns for one of three fiscal years tested exceeded the approved budget, and supporting documents for one quarter could not be located.
3. Supporting documentation could not be located for in-kind contributions and other expenses.

Without adequate financial controls, the risk is high that Federal funds could be misappropriated and not be used to serve children enrolled in Head Start.

The errors we identified can be most attributed to high turnover and a poorly executed accounting software conversion in FY 2000. During our review, however, the Agency hired a new Fiscal Director with relevant experience who is working with an independent consultant to improve fiscal operations.

### CRITERIA:

Three specific categories of criteria that apply to a grantee's financial system and record keeping requirements include:

- (1) **45 CFR 1304.51(g)** - *“Grantee and delegate agencies must establish and maintain efficient and effective record-keeping systems to provide accurate and timely information regarding children, families, and staff and must ensure appropriate confidentiality of this information.”*
- (2) **45 CFR 1304.51(h)** - *“Grantee and delegate agencies must establish and maintain efficient and effective reporting systems that: (1) Generate periodic reports of financial status and program operations in order to control program quality, maintain program accountability, and advise governing bodies, policy groups, and staff of program progress; and (2) Generate official reports for Federal, State and local authorities, as required by applicable law.”*
- (3) **45 CFR 74.53 (b)** - *“Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report. The only exceptions are the following: (1) If any litigation, claim, financial management review, or audit is started before the expiration of the*

*3-year period, the records shall be retained until all litigation, claims or audit findings involving the records have been resolved and final action taken.”*

## **INDIRECT COSTS**

Indirect costs recorded to the general ledger included errors and unsupported transactions, and did not reflect offsets to the base (direct costs) used to calculate indirect costs. For example, there was:

- \$16,905 in reconciliation errors between the Head Start general ledger and the approved budget. Specifically, actual costs reported in the general ledger exceeded the approved budget by \$13,807 in FY 2001 and fell short by \$3,098 in FY 2002.
- \$14,646 in unsupported adjusting entries in FY 2000.
- \$39,936 in offsets to direct costs not reflected in the calculation of indirect costs, nor did supporting records for the offsets provide enough detail to determine whether they applied to allowable costs.

Offsets to direct costs for Head Start stem from the allocation of a USDA (United States Department of Agriculture) surplus. According to USDA regulations, the Agency can use the excess of prices charged for lunches over expenses to improve food quality or services. Our review of related transactions noted that the surpluses ranged from \$9,000 to \$16,000 for the three years we reviewed. The USDA surplus was recorded in a lump sum to the Head Start general ledger at year-end, which reduced the base (direct costs) for calculating indirect costs. However, the Agency did not use the adjusted base to calculate indirect costs nor maintain records that itemized the costs that were offset by the USDA surplus.

## **FEDERAL CASH DRAWDOWNS**

Federal cash drawdowns for one of three fiscal years tested exceeded the approved budget. Specifically, \$69,737 in drawdowns for FY 2001 could not be supported by actual costs claimed.

Each Head Start agency is required to observe steps of organization, management, and administration to assure staff accountability in matters governed by Federal laws and regulations. This includes adopting rules to ensure that:

- effective control is maintained for all funds; and
- actual expenditures are compared with the budgeted amounts; and
- cash management minimizes the risk of cash drawdowns exceeding cash needs.

Our analysis indicated that cash drawdowns of \$1,200,500 for FY 2001 exceed actual costs of \$1,130,763 by \$69,737.

## **UNSUPPORTED IN-KIND CONTRIBUTIONS**

Supporting documentation could not be located for in-kind contributions. Specifically, \$277,429 in in-kind contributions could not be substantiated.

According to 45 CFR 1301.20, the Agency is required to match 20 percent of the Federal grant with cash or in-kind contributions. Contributions can include volunteer hours, donated supplies, space, land, building, and equipment. Our review of in-kind contributions noted that amounts claimed for FY 2000 and FY 2002 were appropriate and adequately supported. However, the Agency could not locate supporting documents for FY 2001.

## **HIGH TURNOVER AND LIMITED TRAINING OF FISCAL DEPARTMENT STAFF CONTRIBUTED TO ACCOUNTING ERRORS**

The errors we identified can be most attributed to high turnover and a poorly executed accounting software conversion in FY 2000. Specifically, the Agency has filled the position of Fiscal Director four times in five years and at least two experienced accountants left in FY 2001. The turnover rate could be the result of relatively low salaries, poor performance, and inexperience. Without skilled leadership and effective training for accounting software, the fiscal department did not consistently:

- have an adequate understanding of how to use the accounting software;
- develop clear audit trails; and
- develop an effective record retention system.

In addition, the Head Start general ledger does not include a cash account nor does the Agency maintain a separate bank account for the program. Instead, a series of transactions take place between the Head Start general ledger and the RCA general ledger, making it difficult to account for cash payments and receipts. Specifically, cash payments and receipts for the Head Start program are recorded to a cash account with similar transactions for other programs.

During our review, however, the Agency hired a new Fiscal Director with relevant experience who is working with an independent consultant to:

- develop a cash flow forecasting process to anticipate cash needs for the entire agency;
- provide controls necessary to ensure the Agency's fiscal integrity;
- develop the accounting staff, including training for accounting software used by the Agency;
- improve the chart of accounts; and
- improve operations including timely reconciliations and closing the books each month.

Actions taken to date by the Agency include implementing a new procedure in which the Head Start Director, the Fiscal Director, and the Executive Director, or an authorized representative from each department, must all review and authorize each drawdown request. In addition to setting out to improve the financial system of the Agency, the Fiscal Director has organized the process for retaining records.

Without adequate financial controls, the risk is high that Federal funds could be misappropriated and not be used to serve children enrolled in Head Start.

## **RECOMMENDATIONS:**

We recommend that the Agency continue to improve its record keeping procedures and financial systems. The Agency's strategy to improve fiscal operations should include training staff and implementing adequate controls to ensure that:

- actual indirect costs recorded to the general ledger are reconciled to the approved budget;
- direct costs reflect any allowable offsets prior to calculating indirect costs, and supporting records list which accounts or costs apply to the offsets;
- there is a clear and supported audit trail for cash transactions;
- total drawdowns should not exceed actual costs allowed by the approved budget; and
- in-kind contributions are supported by source documents.

To further strengthen controls and record keeping, the Agency should consider establishing a cash account in the Head Start general ledger and a separate checking account.

## **MANAGEMENT COMMENTS AND OIG RESPONSE**

The Agency agreed with our findings and has either adopted or plans to adopt corrective actions for each of our recommendations as follows:

- Implement a closing schedule to ensure that indirect costs are recorded to the appropriate period in a timely manner and can be substantiated.
- Offset the USDA surplus against actual Head Start costs. Any reductions in Head Start costs will be reflected in the calculation of indirect costs.
- Document cash drawdowns and ensure that they do not exceed the approved budget. Required documents maintained by the Agency will include copies of vouchers and payroll records, and the executive director and the Head Start program director must approve each cash drawdown

- Develop record retention procedures. Specifically, the Accounts Payable Manager will store records and track and re-file documents used for audits and other purposes.

In general, the Agency plans to improve fiscal operations, including a more traceable audit trail for cash transactions and the training of fiscal staff.



## **APPENDIX**

STEPHEN GELLER  
Executive DirectorSCOTT PHILLIPS  
Chair*Turning hardship into hope*  
.....MAIN OFFICE  
431-2911

November 10, 2003

**CHILD CARE SERVICES**Salem: 893-8446  
Rest of County:  
1-800-310-8333**FUEL ASSISTANCE**Portsmouth area:  
436-3896  
Salem/Derry area:  
898-8435  
Rest of County:  
1-800-639-3896**HEAD START****Main Office**

431-2911

**Centers**Derry: 432-2715  
Epping: 679-2892  
Hampton: 929-4739  
Newmarket: 659-4927  
Portsmouth: 422-8231  
Raymond: 895-9223  
Salem: 893-4470**HOUSING & ENERGY**

431-2911

**LITERACY SERVICES**Exeter: 778-4770  
Portsmouth  
Adult Ed: 422-8233**OUTREACH CTRS.****Main Office**

895-2896

**Centers**Seacoast: 474-3507  
Portsmouth Clients:  
427-2520  
Raymond: 895-2303  
Salem: 893-9172  
Derry: 432-5573**WOMEN, INFANTS & CHILDREN (WIC)**

Exeter: 778-1834

**WORKFORCE DEVELOPMENT****Main Office**

431-2911

**One-Stop Centers**Portsmouth: 436-3702  
Salem: 893-9185  
Seabrook: 474-3507Memo to: Office of Inspector General  
Attn: Tammy LevesqueFrom: Steve Geller  
Sue Bourn *SB*RE: RESPONSE TO DRAFT REPORT "COSTS CHARGED HEAD  
START PROGRAM ADMINISTERED BY ROCKINGHAM COMMUNITY  
ACTION, INC."

We welcome the opportunity to comment in response to the Office of the Inspector General's specific recommendations contained in the draft audit letter dated October 3, 2003:

**1. Indirect Cost Calculation Reconciliation to Budget**

The Fiscal staff calculates the indirect cost for Head Start each month by applying the total provisionally approved indirect rate of 8% to actual costs. Indirect costs over the agreed-upon budget for indirect are allocated to a Community Service Block Grant. It appears that there was no reconciliation procedure to go back and recalculate the actual indirect rate after adjustments were made. A firm closing schedule is in place that does not allow for late entry of items to a previously closed fiscal period. This measure should prevent recording unsubstantiated indirect expenses to the GL. In addition, reconciliation of the agreed-upon indirect rate is now part of the grant year closeout process for Head Start.

**2. Direct Costs Reflect Adjustments Prior to Calculating Indirect Costs**

There will be a regular allocation of food and nutrition staffing costs and paper goods supply costs directly attributable to operating the USDA program from Head Start program operational expense to the USDA program expense. The amount of the allocation will equal the surplus in the USDA program. The full indirect calculation will be based on the expenses in the Head Start program after the allocation has been made. The practice of allocating the surplus at year end directly to Head Start as a means of reducing expenses has been discontinued.

**3. Clear Audit Trail for Cash Drawdowns and**  
**4. Drawdowns Should Not Exceed Approved Budget**

Documentation was difficult to locate for some financial reporting to the funding agency. This may be the result of inadvertently mishandling records during repeated audits and reviews. (Please refer to the next point for explanation.) The current practice for drawdowns includes careful documentation of actual expenses vs. budget to be covered as well as copies of vouchers and payroll records covered by each drawdown. Each voucher indicates the check number and the date of payment. Each drawdown must be approved by the Executive Director and the Head Start Program Director. These measures should control the problem of unsubstantiated drawdowns and/or drawdowns that exceed the approved budget.

**5. In-kind Documentation**

FY 2000 and FY 2001 were subject to several audits by external auditors and funding agencies. Documents were mis-boxed and combined with other years' documents. Going forward, the Accounts Payable Manager will record each box of documents going into storage with a listing of contents that will be kept in duplicate. She will be responsible for managing a log book for each box placed in storage, including numbering each box and affixing a permanent label. Auditors will be asked to sign out any documents given to them and the Accounts Payable manager will be responsible for retrieving and repacking these documents.

We will carefully consider your suggestion to establish a separate cash account for the Head Start program. This measure will allow for a traceable audit trail but it adds the complexity of tracking transfers from a Head Start account to the Agency general account to cover costs such as payroll and benefits that are paid by the Agency.

Several steps are underway to substantially improve the performance of fiscal management at the Agency. Training for fiscal staff on the accounting software package is scheduled for November 2003. This should help streamline work processes that will allow the current staff to focus on grant reconciliation and sound fiscal management practices. Head Start vouchers are being tracked in separate accounts payable batches as much as possible in order to allow for an easily traceable audit trail.

Thank you for your help and consideration given during the audit process. We found your observations and suggestions to be very useful in the process of building a sound fiscal operation to support Head Start.